

Message Text

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ACTION EB-08

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C O N F I D E N T I A L CARACAS 0845

E.O. 11652: GDS
TAGS: ENRG, VE
SUBJECT: OIL PRODUCTION AND EXPORTS DECLINE

REF: CARACAS 10895

1. SUMMARY. OIL PRODUCTION AND EXPORTS ARE CURRENTLY RUNNING ABOUT TWENTY PERCENT BELOW THE 1977 AVERAGE. THIS DECLINE, WHICH BEGAN IN THE FINAL MONTHS OF 1977, IS PRINCIPALLY DUE TO THE RELATIVELY HIGH PRICE OF VENEZUELAN RESIDUAL FUEL OIL, WHICH CONSTITUTES A MAJOR SHARE OF VENEZUELAN EXPORTS, COMBINED WITH SLACK DEMAND AND EXCESS SUPPLIES FROM OTHER PRODUCERS. GOV SPOKESMEN HAVE PLAYED DOWN THE SERIOUSNESS OF THE PROBLEM, BUT IF IT CONTINUES, IT COULD HAVE IMPORTANT POLITICAL, IF NOT ECONOMIC, IMPLICATIONS IN THE SHORT TERM. THE LOW LEVEL OF EXPORTS MAY ALSO BE LINKED, NOW OR IN THE FUTURE, TO THE NATIONALIZATION RELATED OIL COMPANIES PROBLEMS. END SUMMARY.

2. FOR THE FIRST TIME SINCE THE EARLY MONTHS OF 1976, THAT IS THE PERIOD IMMEDIATELY FOLLOWING OIL NATIONALIZATION, VENEZUELA IS ENCOUNTERING SERIOUS DIFFICULTIES IN MAINTAINING OIL EXPORTS. PRODUCTION IN THE FIRST THREE WEEKS OF 1978 AVERAGED 1.79 MILLION BARRELS PER DAY, TWENTY PERCENT BELOW THE 1977 AVERAGE OF 2.24 MILLION, WHICH IN TURN WAS SLIGHTLY BELOW THE
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INTENDED LEVEL FOR 1977 OF 2.29 MILLION BARRELS. THIS CONTINUES A DECLINE WHICH BEGAN IN LATE 1977 (77 CARACAS 11721 AND CARACAS 358). WITH DOMESTIC CONSUMPTION AVERAGING ABOUT 250,000 BARRELS PER DAY, EXPORTS ARE NOW ESTIMATED AT 1.5 TO 1.6 MILLION VERSUS A 2 MILLION PER DAY AVERAGE IN 1977.

3. THIS DECLINE IS RECEIVING INCREASING PUBLIC ATTENTION.

LOCAL OFFICIALS EXPLAIN IT AS ONLY TRANSITORY, THE RESULT OF AN EXCESS OF SUPPLY OF CRUDE OIL ON WORLD MARKETS COMBINED WITH THE EFFECTS OF, UNTIL RECENTLY, A MILD WINTER IN THE US AND RECORD US STOCKS OF RESIDUAL FUEL OIL, VENEZUELA'S MAJOR OIL PRODUCT EXPORT. THEY HAVE ALSO INDICATED THAT PRODUCTION HAS BEEN CUT BACK INTENTIONALLY IN THE LAST FEW WEEKS TO PERMIT SOME OF THE LARGE STOCKS BUILT UP LOCALLY TO BE WORKED OFF. A COMMUNIST PARTY SPOKESMAN HAS TAKEN THE OPPORTUNITY TO BLAME THE DECLINE ON THE MANEUVERINGS OF FOREIGN GOVERNMENTS, CITING THE CREATION BY THE US AND OTHER COUNTRIES OF STRATEGIC RESERVES. IN GENERAL, HOWEVER, THE OFFICIAL PUBLIC POSITION IS THAT THIS IS ONLY A TEMPORARY ABERRATION WITH NO LONG TERM IMPLICATIONS, ALTHOUGH IN PRIVATE THEY TOO ARE VOICING CONCERN.

4. NON-GOVERNMENT OBSERVERS GO WELL BEYOND THIS. THE MARKETING REPRESENTATIVES OF THE MAJOR OIL COMPANIES BUYING VENEZUELAN CRUDE AND PRODUCTS TELL US THAT VENEZUELAN PRICES, PARTICULARLY FUEL OIL, HAVE BEEN HELD TOO HIGH SINCE ABOUT MID-1977 (REFTEL). AS A RESULT, THEY SAY SUPPLIES FROM OTHER SOURCES HAVE TAKEN OVER A LARGE SHARE OF VENEZUELA'S TRADITIONAL FUEL OIL MARKET IN THE US EAST COAST. EXXON, THE MAJOR BUYER, IS SAID TO HAVE PHASED BACK OFFTAKE OF VENEZUELAN FUEL OIL AND CRUDE BY 300,000 TO 400,000 BARRELS PER DAY SINCE MID-1977. THIS WOULD ACCOUNT FOR ALMOST THE FULL AMOUNT OF THE PRODUCTION DECLINE. THE REBATES, DISCOUNTS AND SUBSEQUENT PRICE CUTS OFFERED BY PETROLEOS DE VENEZUELA SINCE NOVEMBER ARE DESCRIBED AS OFTEN TOO LITTLE AND TOO LATE. A CONFIDENTIAL

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FURTHER PRICE CUT IS WIDELY EXPECTED IN FEBRUARY. THE HESITANCY OF PETROLEOS IN REDUCING PRICES OVER THIS PERIOD MAY IN LARGE PART BE POLITICAL IN ORIGIN; THE GOV, A LEADING ADVOCATE OF A PRICE INCREASE IN THE RECENT OPEC MEETING, MAY HAVE BEEN RELUCTANT TO ALLOW ITS NATIONALIZED OIL INDUSTRY TO ADMIT TO THE WEAKENING MARKET CONDITIONS BY CUTTING PRICES SUBSTANTIALLY. ALSO, CONSTANT PRESSURE TO SHOW LARGER AND LARGER EARNINGS AS A RESULT OF NATIONALIZATION MAY BE A FACTOR.

5. SOME SOURCES MAINTAIN THAT IT IS NOW TOO LATE FOR VENEZUELA TO RECOUP MUCH OF THIS LOST GROUND EVEN WITH PRICE CUTS, AND THAT EVEN THE CURRENT COLD WEATHER IN THE US WILL ONLY RESULT IN THE DRAWDOWN OF DOMESTIC US FUEL OIL STOCKS, WITH NO EFFECT ON VENEZUELAN EXPORTS. AN EXXON OFFICIAL NOW SAYS THE CURRENT LOW LEVEL OF PRODUCTION MAY WELL LAST THROUGH MID-YEAR, WHICH ALONE WOULD REPRESENT A LOSS TO THE GOV OF ABOUT \$1 BILLION IN EXPORT EARNINGS. THIS, OF COURSE, ASSUMES THAT OTHER OIL EXPORTERS WILL NOT ACT TO REDUCE THE CURRENT WORLD SURPLUS.

6. COMMENT. AT THIS POINT, IT IS STILL TOO EARLY TO JUDGE HOW LONG EXPORTS WILL REMAIN DEPRESSED. THE SHORT TERM IMPLICATIONS OF SUCH A LOSS IN EARNINGS, SHOULD IT IN FACT OCCUR, MAY

BE PRIMARILY POLITICAL. TAKING PLACE IN THE MIDST OF AN ELECTION YEAR, IT WOULD NOT ONLY TARNISH THE IMAGE OF OIL NATIONALIZATION, BY FAR PRESIDENT PEREZ' MAJOR DOMESTIC ACHIEVEMENT, BUT IT COULD ALSO LEAD TO MORE SERIOUS ATTEMPTS TO FIX BLAME, AT LEAST PART OF WHICH IS LIKELY TO BE DIRECTED AT THE US GOVERNMENT AND US COMPANIES. ECONOMICALLY, IT WOULD PROBABLY HAVE RELATIVELY LITTLE IMMEDIATE EFFECT, IN VIEW OF VENEZUELA'S LARGE FOREIGN RESERVES AND GOOD INTERNATIONAL CREDIT RATING, BUT COULD FOR THE FIRST TIME SHAKE PUBLIC CONFIDENCE IN THE ABILITY OF PETROLEOS DE VENEZUELA TO MANAGE THE INDUSTRY.

6. FINALLY, THE POSSIBILITY CANNOT BE DISCOUNTED THAT THIS PROBLEM MAY NOW OR IN THE FUTURE BE LINKED TO THE PROBLEMS FACED BY THE OIL COMPANIES AS THE RESULT OF NATIONALIZATION. OFFTAKE BY THE
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EX-CONCESSIONAIRES STILL ACCOUNTS FOR THREE-QUARTERS OF NORMAL VENEZUELAN EXPORTS, AND THUS OFFERS A POTENTIAL AND POWERFUL BARGAINING TOOL, EITHER AS A CARROT OR A STICK, FOR THE COMPANIES IN THEIR EFFORTS TO RESOLVE THESE ISSUES. WHETHER OR NOT THE CURRENTY CUTBACK IN OFFTAKE IS IN SOME WAY RELATED TO THE GOV'S EARLIER DALAYS IN RESOLVING THESE PROBLEMS, THE COMPANIES MAY BE ASKED TO RESTORE OFFTAKE TO THE EARLIER LEVELS IN CONNECTION WITH A FAVORABLE SETTLEMENT OF AT LEAST SOME OF THESE PENDING PROBLEMS.
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